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Timothy's Coffees v. an Ottawa Franchisee
Two Interesting Findings re: Damages

On the damages side, there are two interesting findings in this case:

First: the damages awarded were calculated based on the income lost by Mr. Salah, even though technically he is not a party to the franchise agreement which was breached. Mr. Salah assigned his rights as franchisor to a corporation he had incorporated for that purpose. However, the judge chose to quantify the damages as the loss of income suffered by Mr. Salah and the franchisee corporation collectively.

Second: the damages awarded were not reduced by income that Mr. Salah will potentially earn in the future, given that the franchise agreement has been breached. Damages are normally calculated as the difference between: a) the Expected Result (but for the breach), and b) the Actual Result (given the breach). In this case, the damages were calculated based on the Expected Result (Mr. Salah's future income from the coffee shop), but did not deduct the Actual Result (Mr. Salah's future income, given that he will not be running the coffee shop). In layman's terms, Mr. Salah received the income from the coffee shop for the next 10 years as a lump sum, and he is free to earn income during those 10 years.

Summary of the Case[i]

In the fall of 2001, Mr. Salah purchased a Timothy's Coffees franchise from Timothy's. The franchise was located in the food court on the third floor of the Bayshore Shopping Centre in Ottawa. The head lease between Timothy's and the mall owner expired in September 2005. The sub lease between Mr. Salah and Timothy's expired on the same date, as did the franchise agreement. A traditional franchise agreement runs for 10 years. In order to allow Mr. Salah enough time to recoup his investment, Timothy's granted Mr. Salah an option to extend the franchise if Timothy's entered into a new lease with the mall owner.

Mr. Salah then assigned his rights as franchisor to a corporation he had incorporated for that purpose. He continued to be bound to: a) personally participate in the business, and b) be liable to Timothy's under the franchise agreement.

Timothy's negotiated with the mall owner and ended up taking a location on the second floor of the mall. Timothy's did not offer the location to Mr. Salah, and instead sold the franchise to a new franchisee. The court found that Timothy's had breached their obligations to Mr. Salah.

The court addressed the issue of who is the franchisee, and concluded that:

> "the defendant (Timothy's) has maintained a relationship with both the individual franchisee and its assignee corporation. It never intended to accept the corporation in the place of Mr. Salah for all purposes. Accordingly, both have rights to enforce against Timothy's as they are both franchisees."

With respect to damages for past loss of income:

- **Timothy's** calculated the loss of profit to the franchisee corporation. The damages suffered by the franchisee corporation were minimal because the profits were paid to Mr. Salah as wages.
- **Mr. Salah** calculated the loss of profit collectively for the franchisee corporation, and Mr. Salah.
- The court found that the damages for past loss of income should be calculated collectively for the franchisee corporation, and Mr. Salah.

The court went on to find, "an appropriate amount for the breach of the duty of good faith, with a modest apportionment for mental distress, to be $50,000."

Looked at another way, the overall award may be appropriate, particularly in terms of the message which it sends to Timothy's and other franchisors. However, damages for past loss of income are overstated, and damages for breach of duty of good faith, and mental distress, are understated.

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[i] Abdulahmid Salah and 1470256 Ontario Inc. v. Timothy's Coffees of the World Inc., Ontario Superior Court of Justice, October 26, 2009, 2009 CanLII 58066 (ON S.C.)

Peter Macaulay is a CA designated specialist in investigative and forensic accounting.